Extra Space Storage Inc.
Form 10-Q
November 04, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission File Number: 001-32269

EXTRA SPACE STORAGE INC.

(Exact name of registrant as specified in its charter)

Maryland	**20-1076777**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2795 East Cottonwood Parkway, Suite 400

Salt Lake City, Utah 84121

(Address of principal executive offices)

Registrant s telephone number, including area code: **(801) 365-4600**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, as of October 31, 2013, was 111,253,494.

EXTRA SPACE STORAGE INC.

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STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information presented in this report contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions and other information that is not historical information. In some cases, forward-looking statements can be identified by terminology such as believes, expects, estimates, may, will, should, anticipates, intends , or the negative of such terms or other comparable terminology, or by discussions of strategy. We may also make additional forward-looking statements from time to time. All such subsequent forward-looking statements, whether written or oral, by us or on our behalf, are also expressly qualified by these cautionary statements.

All forward-looking statements, including without limitation, management s examination of historical operating trends and estimate of future earnings, are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith and we believe there is a reasonable basis for them, but there can be no assurance that management s expectations, beliefs and projections will result or be achieved. All forward-looking statements apply only as of the date made. We undertake no obligation to publicly update or revise forward-looking statements which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in or contemplated by this report. Any forward-looking statements should be considered in light of the risks referenced in Part II. Item 1A. Risk Factors below and in Part I. Item 1A. Risk Factors included in our most recent Annual Report on Form 10-K. Such factors include, but are not limited to:

- adverse changes in general economic conditions, the real estate industry and the markets in which we operate;
- failure to close pending acquisitions on expected terms, or at all;
- the effect of competition from new and existing self-storage facilities or other storage alternatives, which could cause rents and occupancy rates to decline;
- difficulties in our ability to evaluate, finance, complete and integrate acquisitions and developments successfully and to lease up those properties, which could adversely affect our profitability;
- potential liability for uninsured losses and environmental contamination;

- the impact of the regulatory environment as well as national, state and local laws and regulations including, without limitation, those governing real estate investment trusts (REITs), tenant reinsurance and other aspects of our business, which could adversely affect our results;

- disruptions in credit and financial markets and resulting difficulties in raising capital or obtaining credit at reasonable rates or at all, which could impede our ability to grow;

- increased interest rates and operating costs;

- reductions in asset valuations and related impairment charges;

- the failure of our joint venture partners to fulfill their obligations to us or their pursuit of actions that are inconsistent with our objectives;

- the failure to maintain our REIT status for federal income tax purposes;

- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan; and

- difficulties in our ability to attract and retain qualified personnel and management members.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Extra Space Storage Inc.

Condensed Consolidated Balance Sheets

(amounts in thousands, except share data)

	September 30, 2013 (Unaudited)	December 31, 2012
Assets:		
Real estate assets, net	$ 3,223,672	$ 2,991,722
Investments in unconsolidated real estate ventures	100,455	106,313
Cash and cash equivalents	81,699	30,785
Restricted cash	22,803	16,976
Receivables from related parties and affiliated real estate joint ventures	7,928	11,078
Other assets, net	81,682	66,603
Total assets	$ 3,518,239	$ 3,223,477
Liabilities, Noncontrolling Interests and Equity:		
Notes payable	$ 1,402,432	$ 1,369,690
Premium on notes payable	2,336	3,319
Exchangeable senior notes	250,000	
Discount on exchangeable senior notes	(17,299)	
Notes payable to trusts	119,590	119,590
Lines of credit		85,000
Accounts payable and accrued expenses	58,248	52,299
Other liabilities	34,052	48,248
Total liabilities	1,849,359	1,678,146
Commitments and contingencies		
Noncontrolling interest represented by Series B Preferred Operating Partnership units	33,713	
Noncontrolling Interests and Equity:		
Extra Space Storage Inc. stockholders equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding		
Common stock, $0.01 par value, 300,000,000 shares authorized, 111,236,044 and 110,737,205 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	1,112	1,107
Paid-in capital	1,766,691	1,740,037
Accumulated other comprehensive income (deficit)	3,146	(14,273)
Accumulated deficit	(256,640)	(235,064)
Total Extra Space Storage Inc. stockholders equity	1,514,309	1,491,807

Noncontrolling interest represented by Series A Preferred Operating Partnership units, net of $100,000 note receivable		29,880		29,918
Noncontrolling interests in Operating Partnership		90,504		22,492
Other noncontrolling interests		474		1,114
Total noncontrolling interests and equity		1,635,167		1,545,331
Total liabilities, noncontrolling interests and equity	$	3,518,239	$	3,223,477

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Operations

(amounts in thousands, except share data)

(unaudited)

	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
Revenues:				
Property rental	$ 113,881	$ 94,065	$ 324,144	$ 249,193
Tenant reinsurance	12,294	9,495	34,625	27,060
Management fees	6,936	6,231	19,910	19,476
Total revenues	133,111	109,791	378,679	295,729
Expenses:				
Property operations	34,376	30,115	102,275	82,723
Tenant reinsurance	2,873	1,379	6,985	4,651
Acquisition related costs	2,427	2,486	3,562	3,564
General and administrative	13,943	12,559	40,451	37,744
Depreciation and amortization	23,428	19,768	69,238	52,918
Total expenses	77,047	66,307	222,511	181,600
Income from operations	56,064	43,484	156,168	114,129
Gain on sale of real estate assets			800	
Loss on extinguishment of debt related to portfolio acquisition	(9,153)		(9,153)	
Interest expense	(16,264)	(18,423)	(51,992)	(52,348)
Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes	(834)		(947)	(444)
Interest income	202	461	519	1,184
Interest income on note receivable from Preferred Operating Partnership unit holder	1,213	1,213	3,638	3,638
Income before equity in earnings of unconsolidated real estate ventures and income tax expense	31,228	26,735	99,033	66,159
Equity in earnings of unconsolidated real estate ventures	3,405	2,854	8,942	7,848
Equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of joint venture partners interests		13,620	2,556	19,049
Income tax expense	(2,281)	(1,656)	(7,147)	(4,240)
Net income	32,352	41,553	103,384	88,816
Net income allocated to Preferred Operating Partnership noncontrolling interests	(2,033)	(1,805)	(5,495)	(5,108)

Net income allocated to Operating Partnership and other noncontrolling interests		(1,074)		(1,142)		(2,753)		(2,475)
Net income attributable to common stockholders	$	29,245	$	38,606	$	95,136	$	81,233
Net income per common share								
Basic	$	0.26	$	0.37	$	0.86	$	0.81
Diluted	$	0.26	$	0.37	$	0.84	$	0.80
Weighted average number of shares								
Basic		111,231,452		104,252,227		111,060,997		100,429,840
Diluted		117,604,515		108,755,316		117,483,010		104,981,176
Cash dividends paid per common share	$	0.40	$	0.20	$	1.05	$	0.60

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Comprehensive Income

(amounts in thousands)

(unaudited)

	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
Net income	$ 32,352	$ 41,553	$ 103,384	$ 88,816
Other comprehensive income (loss):				
Change in fair value of interest rate swaps	(2,073)	(3,564)	17,967	(7,296)
Total comprehensive income	30,279	37,989	121,351	81,520
Less: comprehensive income attributable to noncontrolling interests	2,996	2,814	8,796	7,307
Comprehensive income attributable to common stockholders	$ 27,283	$ 35,175	$ 112,555	$ 74,213

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statement of Equity

(amounts in thousands, except share data)

(unaudited)

	Noncontrolling Interests				Extra Space Storage Inc. Stockholders Equity					
	Series B Preferred Operating Partnership	Series A Preferred Operating Partnership	Operating Partnership	Other	Shares	Par Value	Paid-in Capital	Accumulated Other Comprehensive Income (Deficit)	Accumulated Deficit	Total Equity
Balances at December 31, 2012	$	$ 29,918	$ 22,492	$ 1,114	110,737,205	$ 1,107	$ 1,740,037	$ (14,273)	$ (235,064)	$ 1,545,331
Issuance of common stock upon the exercise of options					387,393	4	5,872			5,876
Restricted stock grants issued					132,802	1				1
Restricted stock grants cancelled					(21,356)					
Compensation expense related to stock-based awards							3,654			3,654
Purchase of additional equity interests in existing consolidated joint ventures				(635)			(515)			(1,150)
Issuance of exchangeable senior notes - equity component							14,496			14,496
Issuance of Operating Partnership units in conjuction with portfolio acquisition	33,568		68,471							68,471
Redemption of Operating Partnership units for cash			(41)							(41)
Net income	335	5,160	2,715	38					95,136	103,049
Other comprehensive income	(22)	153	417					17,419		17,989
Tax effect from vesting of restricted stock grants and stock option exercises							3,147			3,147
Distributions to Operating Partnership units held by noncontrolling interests	(168)	(5,351)	(3,550)							(8,901)
Distributions to other noncontrolling interests				(43)						(43)
Dividends paid on common stock at $1.05 per share									(116,712)	(116,712)
Balances at September 30, 2013	$ 33,713	$ 29,880	$ 90,504	$ 474	111,236,044	$ 1,112	$ 1,766,691	$ 3,146	$ (256,640)	$ 1,635,167

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	For the Nine Months Ended September 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 103,384	$ 88,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	69,238	52,918
Amortization of deferred financing costs	4,198	5,016
Loss on extinguishment of debt related to portfolio acquisition	9,153	
Non-cash interest expense related to amortization of discount on exchangeable senior notes	947	444
Non-cash interest expense related to amortization of premium on notes payable	(983)	(951)
Compensation expense related to stock-based awards	3,654	3,318
Gain on purchase of joint venture partners interests	(2,556)	(13,499)
Distributions from unconsolidated real estate ventures in excess of earnings	3,538	1,642
Changes in operating assets and liabilities:		
Receivables from related parties and affiliated real estate joint ventures	891	7,587
Other assets, net	(1,303)	4,866
Accounts payable and accrued expenses	5,949	4,530
Other liabilities	2,474	(1,726)
Net cash provided by operating activities	198,584	152,961
Cash flows from investing activities:		
Acquisition, development and redevelopment of real estate assets	(86,890)	(368,753)
Proceeds from sale of real estate assets	889	
Investments in unconsolidated real estate ventures	(1,126)	(1,053)
Return of investment in unconsolidated real estate ventures		1,848
Change in restricted cash	(5,827)	2,384
Issuance of notes receivable	(5,000)	(7,875)
Purchase of equipment and fixtures	(2,349)	(1,620)
Net cash used in investing activities	(100,303)	(375,069)
Cash flows from financing activities:		
Proceeds from the sale of common stock, net of offering costs		226,692
Net proceeds from issuance of exchangeable senior notes	246,250	
Repurchase of exchangeable senior notes		(87,663)
Proceeds from notes payable and lines of credit	364,855	640,655
Principal payments on notes payable and lines of credit, including defeasance	(532,348)	(473,349)
Deferred financing costs	(6,135)	(8,427)
Redemption of Operating Partnership units held by noncontrolling interest	(41)	(155)
Net proceeds from exercise of stock options	5,876	8,931
Dividends paid on common stock	(116,712)	(60,693)
Distributions to noncontrolling interests	(9,112)	(6,759)
Net cash provided by (used in) financing activities	(47,367)	239,232
Net increase in cash and cash equivalents	50,914	17,124

Cash and cash equivalents, beginning of the period		30,785		26,484
Cash and cash equivalents, end of the period	$	81,699	$	43,608

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	For the Nine Months Ended September 30,			
	2013		2012	
Supplemental schedule of cash flow information				
Interest paid	$	46,360	$	47,816
Income taxes paid		1,626		473
Supplemental schedule of noncash investing and financing activities:				
Tax effect from vesting of restricted stock grants and stock option exercises:				
Other assets	$	3,147	$	3,099
Paid-in capital		(3,147)		(3,099)
Acquisitions of real estate assets				
Real estate assets, net	$	210,372	$	148,021
Notes payable assumed		(7,122)		(147,592)
Notes payable assumed and immediately defeased		(98,960)		
Value of Operating Partnership units issued		(102,039)		(429)
Receivables from related parties and affiliated real estate joint ventures		(2,251)		
Receivable from sale of interest in real estate ventures				
Other assets	$		$	3,349
Investments in unconsolidated real estate ventures	$		$	(3,349)

See accompanying notes to unaudited condensed consolidated financial statements.

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except property and share data

1. ORGANIZATION

Extra Space Storage Inc. (the Company) is a fully-integrated, self-administered and self-managed real estate investment trust (REIT), formed as a Maryland corporation on April 30, 2004, to own, operate, manage, acquire, develop and redevelop professionally managed self-storage facilities located throughout the United States. The Company continues the business of Extra Space Storage LLC and its subsidiaries, which had engaged in the self-storage business since 1977. The Company s interest in its properties is held through its operating partnership, Extra Space Storage LP (the Operating Partnership), which was formed on May 5, 2004. The Company s primary assets are general partner and limited partner interests in the Operating Partnership. This structure is commonly referred to as an umbrella partnership REIT, or UPREIT. The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended. To the extent the Company continues to qualify as a REIT, it will not be subject to tax, with certain limited exceptions, on the taxable income that is distributed to its stockholders.

The Company invests in self-storage facilities by acquiring wholly-owned facilities or by acquiring an equity interest in real estate entities. At September 30, 2013, the Company had direct and indirect equity interests in 754 operating storage facilities. In addition, the Company managed 253 properties for third parties, bringing the total number of operating properties which it owns and/or manages to 1,007. These properties are located in 35 states, Washington, D.C. and Puerto Rico.

The Company operates in three distinct segments: (1) rental operations; (2) tenant reinsurance; and (3) property management, acquisition and development. The rental operations activities include rental operations of self-storage facilities in which we have an ownership interest. No single tenant accounts for more than 5% of rental income. Tenant reinsurance activities include the reinsurance of risks relating to the loss of goods stored by tenants in the Company s self-storage facilities. The Company s property management, acquisition and development activities include managing, acquiring, developing and selling self-storage facilities.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information, and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they may not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2013, are not necessarily indicative of results that may be expected for the year ending December 31, 2013. The condensed consolidated balance sheet as of December 31, 2012 has been derived from the Company s audited financial statements as of that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission.

Certain amounts in the 2012 financial statements and supporting note disclosures have been reclassified to conform to the current period presentation. Such reclassifications did not impact previously reported net income or accumulated deficit.

Recently Issued Accounting Standards

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02 *Comprehensive Income Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which supersedes and replaces the presentation requirements for reclassifications out of accumulated other comprehensive income in ASUs 2011-05 and 2011-12. The amendment requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. ASU 2013-02 was effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. The Company adopted the amended standards beginning January 1, 2013 and presents accumulated other comprehensive income in accordance with the requirements of the standard.

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3. FAIR VALUE DISCLOSURES

Derivative Financial Instruments

Currently, the Company uses interest rate swaps to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate forward curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees. In conjunction with the FASB s fair value measurement guidance, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of September 30, 2013, the Company had assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety were classified in Level 2 of the fair value hierarchy.

The table below presents the Company s assets and liabilities measured at fair value on a recurring basis as of September 30, 2013, aggregated by the level in the fair value hierarchy within which those measurements fall.

		Fair Value Measurements at Reporting Date Using		
Description	**September 30, 2013**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Other assets - Cash Flow Hedge Swap Agreements	$ 7,530	$	$ 7,530	$
Other liabilities - Cash Flow Hedge Swap Agreements	$ (4,953)	$	$ (4,953)	$

There were no transfers of assets and liabilities between Level 1 and Level 2 during the nine months ended September 30, 2013. The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2013.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Long-lived assets held for use are evaluated for impairment when events or circumstances indicate there may be impairment. The Company reviews each self-storage facility at least annually to determine if any such events or circumstances have occurred or exist. The Company focuses on facilities where occupancy and/or rental income have decreased by a significant amount. For these facilities, the Company determines whether the decrease is temporary or permanent, and whether the facility will likely recover the lost occupancy and/or revenue in the short term. In addition, the Company carefully reviews facilities in the lease-up stage and compares actual operating results to original projections.

When the Company determines that an event that may indicate impairment has occurred, the Company compares the carrying value of the related long-lived assets to the undiscounted future net operating cash flows attributable to the assets. An impairment loss is recorded if the net carrying value of the assets exceeds the undiscounted future net operating cash flows attributable to the assets. The impairment loss recognized equals the excess of net carrying value over the related fair value of the assets.

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When real estate assets are identified by management as held for sale, the Company discontinues depreciating the assets and estimates the fair value of the assets, net of selling costs. If the estimated fair value, net of selling costs, of the assets that have been identified as held for sale is less than the net carrying value of the assets, then a valuation allowance is established. The operations of assets held for sale or sold during the period are generally presented as discontinued operations for all periods presented.

The Company assesses whether there are any indicators that the value of its investments in unconsolidated real estate ventures may be impaired annually and when events or circumstances indicate there may be impairment. An investment is impaired if management s estimate of the fair value of the investment is less than its carrying value. To the extent impairment has occurred, and is considered to be other than temporary, the loss is measured as the excess of the carrying amount over the fair value of the investment.

In connection with the Company s acquisition of self-storage facilities, the purchase price is allocated to the tangible and intangible assets and liabilities acquired based on their fair values, which are estimated using significant unobservable inputs. The value of the tangible assets, consisting of land and buildings, is determined as if vacant. Intangible assets, which represent the value of existing tenant relationships, are recorded at their fair values based on the avoided cost to replace the current leases. The Company measures the value of tenant relationships based on the rent lost due to the amount of time required to replace existing customers, which is based on the Company s historical experience with turnover in its facilities. Debt assumed as part of an acquisition is recorded at fair value based on current interest rates compared to contractual rates. Acquisition-related transaction costs are expensed as incurred.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, receivables, other financial instruments included in other assets, accounts payable and accrued expenses, variable-rate notes payable, lines of credit and other liabilities reflected in the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012 approximate fair value.

The fair value of the Company s note receivable from Preferred Operating Partnership unit holder was based on the discounted estimated future cash flows of the note (categorized within Level 3 of the fair value hierarchy); the discount rate used approximated the current market rate for loans with similar maturities and credit quality. The fair values of the Company s fixed-rate notes payable and notes payable to trusts were estimated using the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximated current market rates for loans, or groups of loans, with similar maturities and credit quality. The fair value of the Company s exchangeable senior notes was estimated using an average market price obtained from a third party.

The fair values of the Company s fixed-rate assets and liabilities were as follows for the periods indicated:

	September 30, 2013		December 31, 2012	
	Fair Value	**Carrying Value**	**Fair Value**	**Carrying Value**
Note receivable from Preferred Operating Partnership unit holder	$ 104,299	$ 100,000	$ 108,138	$ 100,000
Fixed rate notes payable and notes payable to trusts	$ 1,272,278	$ 1,269,205	$ 1,342,957	$ 1,275,605

Exchangeable senior notes	$	253,500	$	250,000	$		$	

4. NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average common shares outstanding, including unvested share-based payment awards that contain a non-forfeitable right to dividends or dividend equivalents. Diluted earnings per common share measures the performance of the Company over the reporting period while giving effect to all potential common shares that were dilutive and outstanding during the period. The denominator includes the weighted average number of basic shares and the number of additional common shares that would have been outstanding if the potential common shares that were dilutive had been issued, and is calculated using either the treasury stock or as if-converted method. Potential common shares are securities (such as options, convertible debt, exchangeable Series A Participating Redeemable Preferred Units (Series A Units) and Series B Redeemable Preferred Units (Series B Units) (together, Preferred OP Units) and exchangeable Operating Partnership units (OP Units)) that do not have a current right to participate in earnings but could do so in the future by virtue of their option or conversion right. In computing the dilutive effect of convertible securities, net income is adjusted to add back any changes in earnings in the period associated with the

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convertible security. The numerator also is adjusted for the effects of any other non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per share, only potential common shares that are dilutive (those that reduce earnings per share) are included.

The Operating Partnership had $250,000 of its 2.375% Exchangeable Senior Notes due 2033 (the Notes) issued and outstanding as of September 30, 2013. The Notes could potentially have a dilutive effect on the Company s earnings per share calculations. The Notes are exchangeable by holders into shares of the Company s common stock under certain circumstances per the terms of the indenture governing the Notes. The exchange price of the Notes was $55.69 per share as of September 30, 2013, and could change over time as described in the indenture. The Company has irrevocably agreed to pay only cash for the accreted principal amount of the Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligation in excess of the accreted principal amount in cash and/or common stock. Though the Company has retained that right, Accounting Standards Codification (ASC) 260, *Earnings per Share,* requires an assumption that shares would be used to pay the exchange obligation in excess of the accreted principal amount, and requires that those shares be included in the Company s calculation of weighted average common shares outstanding for the diluted earnings per share computation. For the three and nine months ended September 30, 2013 no shares related to the Notes were included in the computation for diluted earnings per share as the per share price of the Company s common stock during this period did not exceed the exchange price.

For the purposes of computing the diluted impact on earnings per share of the potential conversion of Series A Units into common shares, where the Company has the option to redeem in cash or shares and where the Company has stated the positive intent and ability to settle at least $115,000 of the instrument in cash (or net settle a portion of the Series A Units against the related outstanding note receivable), only the amount of the instrument in excess of $115,000 is considered in the calculation of shares contingently issuable for the purposes of computing diluted earnings per share as allowed by ASC 260-10-45-46.

For the purposes of computing the diluted impact on earnings per share of the potential conversion of Series B Units into common shares, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series B Units outstanding at September 30, 2013, or $33,568, by the closing price of $45.75 per share at September 30, 2013. Assuming full conversion to common shares as of September 30, 2013, 733,731 shares would have been issued to holders of the Series B units.

For the three months ended September 30, 2013 and 2012, options to purchase 51,036 and 15,223 shares of common stock, respectively, and for the nine months ended September 30, 2013 and 2012, options to purchase 43,273 and 54,959 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive. All restricted stock grants have been included in basic and diluted shares outstanding because such shares earn a non-forfeitable dividend and carry voting rights.

The computation of net income per common share was as follows for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income attributable to common stockholders	$ 29,245	$ 38,606	$ 95,136	$ 81,233
Add: Income allocated to noncontrolling interest - Preferred Operating Partnership and Operating Partnership	3,092	2,938	8,210	7,563

Subtract: Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership		(1,438)		(1,438)		(4,313)		(4,313)
Net income for diluted computations	$	30,899	$	40,106	$	99,033	$	84,483
Weighted average common shares outstanding:								
Average number of common shares outstanding - basic		111,231,452		104,252,227		111,060,997		100,429,840
Operating Partnership units		4,346,618		3,060,467		4,346,618		3,060,467
Series A Preferred Operating Partnership units		989,980		989,980		989,980		989,980
Series B Preferred Operating Partnership units		733,731				733,731		
Shares related to dilutive and cancelled stock options		302,734		452,642		351,684		500,889
Average number of common shares outstanding - diluted		117,604,515		108,755,316		117,483,010		104,981,176
Net income per common share								
Basic	$	0.26	$	0.37	$	0.86	$	0.81
Diluted	$	0.26	$	0.37	$	0.84	$	0.80

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5. PROPERTY ACQUISITIONS AND DISPOSITIONS

The following table summarizes the Company s acquisitions of operating properties for the nine months ended September 30, 2013, and does not include purchases of land, purchases of additional equity interests in existing consolidated joint ventures or improvements made to existing assets:

			Consideration Paid									Acquisition Date Fair Value				
Property Location	Number of Properties	Date of Acquisition	Total	Cash Paid (1)	Loans Assumed (1)	Non-cash gain	Notes Issued to/from Seller	Previous equity interest	Net Liabilities/ (Assets) Assumed	Value of OP Units Issued	Number of OP Units Issued	Land	Building	Intangible	Closing costs - expensed	Notes
Maryland	1	2/13/2013	$ 12,321	$ 8,029	$	$ 2,215	$	$ 2,273	$ (196)	$		$ 1,266	$ 10,789	$ 260	$ 6	(2)
Illinois																